Service Date: April 22, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of	)	UTILITY DIVISION
MONTANA-DAKOTA UTILITIES	)	
COMPANY for Authority to Establish	)	DOCKET NO. 81.7.62
Permanent Increased Rates for Gas	)	
Service in the State of Montana.	)	ORDER NO. 4834c

I N D E X

Page

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of MONTANA-DAKOTA UTILITIES COMPANY for Authority to Establish Permanent Increased Rates for Gas Service in the State of Montana.	)	UTILITY DIVISION DOCKET NO. 81.7.62 ORDER NO. 4834c

APPEARANCES

FOR THE APPLICANT:

Joseph R. Maichel, Attorney at Law, 400 North Fourth Street, Bismarck, North Dakota 58501

John Alke, Attorney at Law, Hughes, Kellner, Sullivan and Alke, 406 Fuller Avenue, Helena, Montana 59601

FOR THE PROTESTANTS:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana, appearing on behalf of the consuming public of the State of Montana

John C. Allen, Consumer Counsel Staff Attorney, 34 West Sixth Avenue, Helena, Montana, appearing on behalf of the consuming public of the State of Montana

FOR THE INTERVENORS:

Jerome Anderson, Attorney at Law of the firm of Anderson, Brown, Gerbase, Cebull & Jones, P. C., 100 Transwestern I, 404 North 31st Street, Billings, Montana, appearing on behalf of Pierce Packing Company, Midland Empire Packing Co., Midland Foods Distributing Co., and Midland Foods, Inc.

C. W. Leaphart, Attorney at Law of the Leaphart Law Firm, 1 North Last Chance Gulch, Helena, Montana, appearing on behalf of Great Western Sugar Company and Holly Sugar Company

FOR THE COMMISSION:

Eileen E. Shore, Staff Counsel Opal Winebrenner, Staff Counsel Dan Elliott, Administrator, Utility Division Dennis Crawford. Asst. Administrator Utility Division

BEFORE:

THOMAS J . SCHNEIDER, Commissioner & Hearing Examiner
GORDON E. BOLLINGER, Chairman
JOHN B. DRISCOLL, Commissioner
HOWARD L. ELLIS, Commissioner
CLYDE JARVlS. Commissioner

FINDINGS OF FACT

Section A - General

1. Montana-Dakota Utilities Company (MDU or Applicant) is a public utility furnishing natural gas service to consumers in the State of Montana.

2. Applicant's petition, received July 13, 1981, requests this Commission's approval of rates and charges for natural gas service which are an increase in annual gross operating revenues of designed to produce $7,242,000.

3. As part of the application, MDU requested interim relief in the amount of $2,260,000 to take effect on September 1, 1981, with the balance of $4,982,000 to become effective December 1, 1981.

4. On August 10, 1981, the Commission issued Interim Order No. 4834 authorizing interim rate relief of $4,181,500.

5. On September 28, 1981 MDU issued a notice to all parties involved in these proceedings, stating that MDU had made an error in preparing its case and that, as a consequence, the proper make-whole interim adjustment was not $4,181,500 but $2,081,500.

6. On October 5, 1981 the Commission authorized interim rate relief reflecting increased annual revenues of $2,081,500 and revoking the interim relief of $4,181,500 granted in Order No. 4839. New rate schedules filed carried an effective date of "Bills rendered on and after October 5, 1981. " The "bills rendered basis" gave the customers the immediate full effect of the reduction on any bill issued on or after October 5, 1981.

7. During the period that interim rates, as authorized by Order No. 4834 were in effect (August 10th through October 2, 1981), MDU overcollected approximately $41,800 from residential and general gas service customers and approximately $28,000 from its industrial customers.

8. MDU refunded to customers the amounts overcollected, including interest, in the following manner:

> With respect to residential and commercial customers, the amount of refund will be computed by taking the expected volumes of the designated billing cycle divided into the overcollected amount of $41,800, plus interest. MDU will calculate on an individual basis the amount of credit due each industrial customer. This can be accomplished since all industrial customers are handbilled. The appropriate credit will be included on each customer's next bill as stated below.
>
> With bills rendered on or before October 19, 1981, MDU will include a separate line item on each customer's service bill setting forth the amount of the refund credited to that customer's bill with an appropriate printed message explaining the reason for the credit. These credits would apply for one full billing cycle to assure that all customers receive an appropriate credit.

9. A report showing the amount refunded to customers was submitted to the Commission.

10. MDU's adjusted rate request would generate approximately $5,143,000 additional revenues annually.

11. In a recent MDU electric rate case, Docket No. 81.1.2, the Commission ordered a substantial revision to MDU's capital structure (Order Nos. 4799b and 4799c, issued October 20, 1981). The Commission found that the revision to MDU's capital structure in Docket No. 81.1.2 called for a revision to MDU's natural gas rates. l his revision required a reduction of annual gas revenues of $273,000 and Order No. 4834b was issued.

12. A Notice of Public Hearing was issued on December 7, 1981 and legal notice was published in eight (8) newspapers in MDU's service area.

13. On January 5, 1982 commencing at 10:00 a.m., a hearing was held at the City Library, 510 North Broadway, Billings, Montana. A special evening session was held at 7:00 p . m. on January 5, 1982 at the same location as the general hearing. A separate "satellite hearing" was held on January 6 , 1982 at 7:30 p . m . at the Miles City Community College, Miles City, Montana. Special evening sessions are held to encourage the general public's participation at rate proceedings.

Both sessions attracted large crowds which were very vocal in their opposition to any additional natural gas rate increases. They expressed deep concerns about senior citizens, low income, fixed income, unemployed and the average citizen's ability to pay the ever increasing cost of heating their homes. They testified that inflation and high interest rates have impacted their lives also and their income has not kept pace with these increases.

The Commission is very concerned about the impacts that deregulation of natural gas at the wellhead has had on the Montana ratepayer. These increased gas costs have been reflected in utility rates. All consumers are feeling acutely the effects of constantly increasing prices. These prices are causing, not mere unconveniences, but intense human hardship. In letters to the Montana Congressional delegation, dated February

10, 1982, the Commission very strongly voiced their opposition to accelerated deregulation.

14. The company has proposed a December 31, 1980 test year. The Commission accepts this test year and also notes that the application was not filed until July 13, 1981, six and one-half months after the test year end.

Section B - Revenue, Expense and Rate Base

15. Donald R. Ball sponsored testimony and exhibits which related to cost of service and rate base amounts for the Applicant. His prefiled testimony has been marked "Exhibit 15" and his prefiled exhibits have been marked "Exhibit 16."

16. George F. Hess presented testimony and exhibits which concerned adjustments to test year expenses and rate base amounts for MCC. His prefiled testimony and exhibits were marked as "MCC Exhibit 1."

Wages

17. The Company adjusted test year labor costs to reflect increased wage rates effective at year end 1980. In addition, the Company adjusted the test year labor force to the number of employees at year end.

18. Mr. Hess recommended an adjustment which would limit the wage increase of the Applicant to the average number of employees during the test year rather than the employees at the end of the test year. In his testimony, Mr. Hess indicates the reasons why year-end levels of employees do not satisfy the test year concept:

> . . . Since the actual test year workload was handled by the test year work force, there is no reason to assume that additional employees are required to do the same work.
>
> (MCC Exhibit 1, p. 3)

19. The expense associated with new employees will be matched with revenue from new business, according to MCC. Further, other concerns exist if test year labor costs are ad justed for the annualized cost of new employees added during the year:

> . . . New employees added during the test year might reduce overtime requirements or reduce the services of outside contractors, and thus, require some further adjustment to test year expenses not considered by the company.
> (Exhibit 1, p . 3)

20. In evaluating the wage adjustment proposed by MCC, the Commission finds itself confronted with a matching question. What employee level best represents the test year work force? Past decisions by this Commission have adopted the test year average for wages and also for rate base. Based upon the evidence in the record, the Commission finds the average number of employees in the test year to be proper. The Commission accepts a reduction in wages in the amount of $102,000.

Fringe Benefits

21. MDU used a number of methods to estimate increases in fringe benefits. Holiday, vacation, sick pay, and miscellaneous nonproductive time were increased in proportion to the annualized payroll adjustment. Worker's compensation, group hospitalization and life insurance, and pension costs include 1981 costs for employees added during the test year.

22. MCC recommended a number of adjustments which have the effect of reducing fringe benefits expense to the actual level experienced in the 12 months ended June 30, 1981. All MDU adjustments to test year actual data were eliminated by MCC.

23. In the attempt to provide the Commission with all possible information, MDU incorporated estimates and projections in their fringe

benefit figures. Two serious concerns exist with the use of estimates and projections: (1) since these events have not yet taken place, they are not measurable with any accuracy; and (2) use of projections results in an improper matching of test year revenues with some future expense. In contrast, known and measurable changes are accepted as proper adjustments to the test year. Therefore, the MCC adjustments in fringe benefits are accepted as proper adjustments to the test year. Therefore, the MCC adjustments in fringe benefits are accepted as being accurate modifications of test year expenses. A reduction of fringe benefit expense in the amount of $48,000 is accepted by the Commission.

Postage

24. MDU included an upward adjustment of 20 percent in postage expense to reflect the 1981 increase from 15 cents to 18 cents. Because of the further increase to 20 cents, MCC proposes to adjust postage expense upward by an additional 11 percent to reflect this increase. The Commission accepts the MCC proposal as a known and measurable change, and postage expense is accordingly increased in the amount of $16,000.

Gas Royalties - Federal Leases

25. MDU adjusted test year gas royalty expenses of federal leases to reflect higher royalties that were not actually being paid. Mr. Price indicated that the company has appealed the higher royalties claimed by the U. S. Geological Survey. MDU's adjustment, therefore, centered around the possibility of having to pay increased royalty payments on federal leases.

26. MCC witness Hess reversed the company adjustment for such gas royalty expenses. Mr. Hess commented as to the proper timing and recognition of gas royalty expense:

> MDU should be allowed to recover the higher royalties on federal leases when they become known and payable. In addition, MDU should be allowed to amortize any amounts paid retroactively in excess of the amounts allowed for rate making purposes for past periods, but in the meantime it should not be allowed to charge expenses not now known or incurred.
> (Exhibit 1, p. 6)

27. The controversy over this adjustment again focuses on the issue of known and measurable changes. Since MDU's adjustment is based on estimates and projections rather than actual figures, the Commission accepts MCC's proposal of a reduction of gas royalty expenses for federal leases in the amount of $57,000.

Interest on Tax Refund

28. MCC witness Hess raised the question as to why interest received on tax refunds should not be passed on to ratepayers, since interest assessed by the Internal Revenue Service is charged to ratepayers in MDU's adjustment No. 18 (Exhibit G-23). MDU responded that since interest paid on federal income taxes is charged to ratepayers with a three year amortization, it is fair to pass along the interest received on the same basis. Mr. Hess' adjustment reflects a three year amortization of interest received in 1980 on a tax refund resulting from the carryback of investment tax credits to 1976.

The Commission accepts Mr. Hess' adjustment in the amount of $11,000.

Payroll Taxes

29. The company adjusted test year payroll taxes based on the number of employees at year's end. Mr. Hess recommended an adjustment

which would reflect the use of the average number of employees rather than MDU's figures. For reasons previously mentioned in the wages section, the Commission accepts the adjustment of MCC. The proper reduction in payroll tax expense is $18,000.

Capitalized Taxes and Pensions

30. The Company adjusted capitalized payroll taxes and pension costs to a three year average of these items. Mr. Hess rejected this adjustment and further explained:

> I reject this adjustment because (1) the payroll taxes and pension costs for the years 1978 through 1980 were not adjusted to reflect the current levels for these costs, and (2) there is no evidence that gas construction will be declining in the immediate future.
>
> (MCC Exhibit 1, p . 7)

31. The Commission finds there is insufficient evidence that the use of an average is justified for these costs, and accepts the MCC adjustment. The reduction in capitalized taxes and pensions in the amount of $14,000 is approved.

Excess Deferred Taxes

32. In 1979 the federal corporate income tax was reduced from 48 to 46 percent. The accumulated deferred taxes which were accrued at 48 percent do not reflect taxes which will have to be paid. Mr. Hess proposed to return the excess deferred taxes to ratepayers over a two year period. MDU argues that this adjustment violates Internal Revenue Regulations which prohibit reductions of the aggregate amount allocable to deferred taxes "except to reflect the amount in any taxable year by which federal income

taxes are greater by reason of the prior use of different methods of depreciation."

33. The Company and MCC agree that such amounts should be returned to the ratepayers. The issue pertains to the period over which the amounts are to be returned. MDU recommends that the excess amounts be left in the deferred tax account until the property is completely depreciated. Their position is that:

> The procedure by which the amounts are returned must comply with IRS regulations relating to adjustments to the reserve account so that the Company's right to utilize accelerated depreciation for federal income tax purposes is not jeopardized.
> (MDU Opening Brief, p. 40)

Because of previous Commission decisions concerning this issue, MDU believes that such action has already jeopardized its right to claim accelerated depreciation, and that continued application of such an order in this present case will only compound an already serious situation.

34. MCC argues that no possible benefit can be derived by waiting for the expiration of the properties' useful life pertaining to the period over which the amounts are to be returned. Concerning the company's contention that Mr. Hess' adjustment violates certain Treasury Regulations, MCC states:

> . . . This regulation was promulgated as a companion to the code as it existed before the reduction in corporate tax rates. The regulation should not be read to govern a condition clearly not contemplated when the regulation was written.
> (MCC Brief, p. 2)

35. In Order Nos. 4784 and 4799b, the Commission accepted Mr. Hess' similar adjustments and ordered the company to pass back to ratepayers over a two year period the excess deferred federal income taxes accrued at tax rates higher than the currently effective 46 percent tax rate.

Consistent with these past Commission decisions on this issue, the adjustment proposed by MCC witness Hess is accepted, and the amortization of the excess deferred taxes over two years is accepted as a reasonable time period. The fact that the applicable Treasury Regulations did not contemplate a change in the tax rate is not adequate support for the maintenance of an excessive accrual at the expense of the ratepayer. Deferred taxes are reduced by $62,000 in the test period.

Deferred Tax Correction

36. In his testimony, Mr. Hess claimed that MDU's exhibits overstated test year deferred income tax expense. The Commission was notified of that error in Mr. Glynn's September 28, 1981 letter. MDU, in response to a data request from Mr. Hess, agreed that the adjustment on their exhibit was in error.

> All parties were notified of this error and interim rates have been reduced to eliminate the effect of the error. Refunds will be made in accordance with the procedure accepted by the Commission.
> (MDU Data Response to Hess Question No. 9)

37. The Commission accepts the adjustment of Mr. Hess and orders deferred tax expense to be reduced in the amount of $1,057,000.

Unamortized Investment Tax Credits

38. MCC witness Hess made an adjustment which shows the reduction in rate base that results if post-1970 unamortized investment tax credits are restated to reduce the credits ratably over the life of the property (figured to be approximately 34 years) rather than a period of 20 years as supported by MDU. Concerning the Company's use of 20 years, Hess states that:

> It has and is amortizing all investment tax credits over a period of 20 years which is considerably shorter than the average life of the property. Consequently, MDU is and has been diminishing the rate base reduction more rapidly than is required, and thereby denying ratepayers the full credit for the investment tax credits they have been charged through utility rates.
> (MCC Exhibit 1, p. 10)

Hess stated that the only ratemaking effect of the more rapid amortization of the investment tax credits for book purposes is to reduce the rate base deduction more rapidly than necessary. MCC supported the concept that ratepayers should be given the maximum recognition allowed for the capital contributions they have made to MDU. This would be accomplished through extended rate base reductions of the unamortized investment tax credit balances.

39. The company believes the MCC adjustment makes a revision in the annual percentage rate at which the investment credit is being restored at the beginning of the 34 year period, and makes it retroactive. MDU claims that if an adjustment of this nature is to he made, to comply with the Treasury Department regulations the revised rate must be used only beginning with the period in which the revision is made -- in this case, the test year.

> As a result of Mr. Hess' failure to follow the clear mandate of the regulations, his proposal results in a negative adjustment to rate base in the test year, the effect of which, as Mr. Kolbe has pointed out, is to reduce the Company's rate base rather than increase it in the test year.
> (MDU Opening Brief, p. 43)

40. The issue in this case is how long post-1970 investment tax credits should be amortized. Mr. Kolbe indicates that the Commission should accept a 20 year amortization. The Commission believes that the company

has failed to meet its burden of proof as to why a 20 year amortization period is preferable to amortization over the life of the property. The Commission finds that the adjustment proposed by Mr. Hess is reasonable and, based on its independent analysis of the tax affect, does not threaten the Applicant's use of investment tax credits. A rate base reduction in the amount of $48,000 is found to be proper.

Pro Forma Interest Expense

41. MCC witness Hess calculated pro forma interest expense using the same procedure used by the company in its exhibit. The interest expense Hess calculated is slightly higher than the company's because he used his adjusted rate base and MCC witness Basil L. Copeland's weighted debt cost rather than the rate base and weighted debt cost proposed by MDU.

42. The Commission accepts the MCC adjustment of a reduction in interest expense in the amount of $1,000.

"Conditional Adjustment"

43. Company witnesses W. C. Glynn and J. A. Schuchart propose a "conditional adjustment" of $2,500,000 based on D. R. Ball's analysis of the company's past inability to earn its allowed rate of return and its projected 1981 deficiency.

44. With regard to the Company's claim the Commission finds:

(a) The principle of retroactive ratemaking prohibits recouping past deficiencies.

(b) The Commission has already considered MDU's 1981 projected deficiency. The company filed its application on July 13, 1981 for an increase in rates of $7, 242,000 or $4, 742,000 without the Conditional Adjustment. Included therein was a request for interim rates of <u>$2,260,000</u> to become effective <u>September 1,</u>

1981 with the balance to become effective December 1, 1981. The Commission approved interim relief on August 10, 1981 in the amount of $4,181,500 or 88% of the company's request without the "Conditional Adjustment."

45. The company argues that any and all past deficiencies are the result of Commission ratemaking practices, namely the use of an historic test year (See Glynn's Direct Testimony, Exh. 15).

46. The Commission notes that perhaps part of the reason for MDU's inability to earn its allowed return lies at its own doorstep. Hess pointed out that a major reason for the company's past shortfall was its inability to timely recover the increasing cost of gas: "MDU was not allowed to track those increases in a timely manner, and as a result Montana gas earnings suffered. " (Hess Direct MCC Exh. 1, p. 14)

47. The Commission notes some of its previous orders, which establish why MDU was not allowed to timely track its gas costs.

From Docket No. 6773:

> The Commission finds the current gas cost adjustment to be less convincing. The adjustment is based on gas volumes projected to the year ended July 31, 1980 and applied to October, 1979 NGPA prices. The October, 1979 prices constitute known and measurable changes; however, July 31, 1980 projected volumes do not, and further are not supported in the record.
>
> The projected volumes constitute a dramatic swing in the mix of gas from that approved in Docket No. 6567, MDU's last general rate case:

	Approved in Docket No. 6567	Projected in this Docket for the Year Ended July 31, 1980
Purchased	45,676,776 Mcf	61,917,800 Mcf

Storage, Net	-0-	(16,866,882)
Produced	6,714,584	4,696,700
Total	52,391,360 Mcf	49,747,618 Mcf

> MDU did not present policy witnesses or gas supply experts to justify such a change. Consumer Counsel pointed out the lack of testimony and evidence supporting the change in mix through cross-examination of MDU's only witness, Don Ball, a senior rate analyst.
>
> (Docket No. 6733, Order No. 4588, Finding No. 7)

From Docket No. 80.4.1:

> The Commission finds the current gas cost adjustment unconvincing. The adjustment is based on gas volumes projected or annualized to the year ended January 31, 1980 and applied to April, 1980 NGPA prices.
>
> Procedures used by the company to annualize January 31st volumes, make use of best guess information or events projected to occur after the application has been filed:
>
> Q. In other words, your -- would you explain exactly for the purposes of this proceeding how you annualized the production of the purchased gas?
>
> A. From the particular sources?
>
> Q. From any source, I suppose.
>
> A. Taken the 12-months actual ended January 31, 1980 and looking at the declining curve to see what the pattern of production occurred, if it was from a well source or from a plant source, and annualizing that based

on that pattern of production making an adjusted figure and also adding in any known significant changes plus any known new sources that would be added to that particular source as being annualized.

Q. When you say taking into consideration any significant changes, during what period of time would those significant changes have taken place?

A. Up to May 1st.

Q. How could you do that when you filed it on March the 31st.

A. If we knew a well was coming on between now and then, it would have been added in to the annualized. or the adjusted figure.

Q. But, it wasn't a known change, it was a predicted change, under those circumstances if it occurred between March 31st and May 1st?

A. It's based on known facts that we had at the time.

(Tr. pp. 120-121, Mr. Leaphart cross-examining Mr. Kasper.)

An example of a projection included in MDU's filing which did not materialize is explained by Mr. Kasper:

Q. Are there any other changes that need to be made to Exhibit A at this time?

A. Referring to page nine of nine of Exhibit A on line thirty the J & B Producing Company there were new wells that were supposed to be connected by the producer and they have not been connected as yet. So, the adjusted volume of 109,500 should be deleted and the

cost of $253,821 should be deleted . (Tr. p. 85, 86)
(Docket No . 80.4.1, Order No . 4726, Finding Nos . 17, 18, and 19)

From Docket No. 80.10.87:

As in the two preceding MDU tracking cases, the Commission finds the Current Gas Cost Adjustment unconvincing in that it relies heavily on the application of October, 1980 NGPA prices to volumes projected through year-ending January 31, 1981. (See Exhibits A, B, C and D in MDU's prefiled exhibits.) As noted in previous orders, the use of projected volumes " . . . provides the opportunity, whether intentional or unintentional, for overestimating gas costs. " The potential for inaccurate measurements is once again evident in the present filing:

Q. Are those wells included in this case?

A. Yes, I believe, they are.

Q. And, they are not on line yet?

A. Some of those are certainly on, but probably some of the wells are not on line yet.

Q. Could you identify for us the ones that are on line?

A. Not specifically. As I said, these are contracts which are contracted by Kansas-Nebraska Natural Gas Company. We can get that information from them if you would like, or a breakdown as to what those statistics are, or volumes are. (Tr. pp. 17-18, direct testimony of D. Price.)
(Docket No . 80.10.87, Order No. 4742, Finding No. 14)

48. The company contended in those proceedings that its use of projections had never resulted in overcollection. However, in response to cross-examination in this proceeding, it appeared those reassurances could no longer be given:

> Q. Mr. Ball, on H-3, Page 3 that you just referred to, how is it that the other jurisdictions have a positive deferred-gas-cost balance of nearly $3 million?
>
> A. That's simply what it was, and what that says is that in North Dakota, South Dakota, and in our FERC jurisdiction, we had a minor problem with our purchased-gas-adjustment procedure, and we simply had overcollected at that time. And a positive deferred gas balance means that you've overcollected. And that has since been refunded to customers in those jurisdictions. (Tr. p. 213)

49. The company did not lose its right to reflect in rates amounts discussed in Docket Nos . 6733, 80.4.1 and 80.10.87. In Docket No . 81.4.45 the Commission approved amortization of these amounts, since the company had complied with Commission filing requirements in that case:

> The Commission also finds the buildup of the large deferred balance to be directly attributable to MDU's failure to meet its burden of proof. (See Order Nos. 4588, 4726 and 4742)
>
> In order to reduce the unusually harsh impact that would result if amortization were to occur over six months, the Commission finds deviation from the tariff in the form of amortization over 12 months as suggested by the parties to be in the best interests of the consumer in this case.
>
> (Docket No. 81.4.5, Order No. 4820a, Finding No. 9)

50. Hess also points out other factors alleviating the problem of attrition the company has raised:

> Second, this Commission has started granting interim rate relief on a timely basis. On August 10 the Commission granted MDU rate relief on an interim basis pending final disposition of this proceeding. The granting of interim rate relief goes a long way toward answering Mr. Glynn's complaints concerning the use of stale data.
> The third significant step which this Commission took to alleviate MDU's problems is its approval of the Frontier transaction. Gas sold to Frontier is now out of MDU's rate base. The return on Frontier's investment in stored gas is now a part of purchased gas costs and will be recovered automatically from MDU's customers through the deferred gas cost accounting. Thus, MDU will be guaranteed a fair return on stored gas that was formerly in rate base.
> (Hess Direct Testimony, MCC Exh. 1, p. 15)

51. Based on the above analysis, the Commission finds the "Conditional Adjustment" is not warranted.

52. The Commission finds the following revenues, expenses and rate base:

Montana-Dakota Utilities Company
Gas Utility - Montana
Results of Operations
December 31, 1980 Test Year
(000)

		Per Books (A)	Company Adjustments (B)	Adjusted Per Company (C)	Commission Adjustments (D)	Adjusted (E)
1.	Operating Revenue	$ 33,043	$ 6,239	$ 39,282	$ -	$ 39,282
2.	Expenses					
3.	Cost of Gas	20,004	545	20,549	-	20,549
4.	Operation & Maintenance	10,196	1,165	11,361	(202)	11,159
5.	Total Operation and Maintenance	$ 30,200	$ 1,710	$ 31,910	$ (202)	$ 31,708
6.	Depreciation and Depletion	$ 1,783	(13)	1,770	-	1,770
7.	Taxes Other than Income Taxes	925	88	1,013	(18)	995
8.	Federal and State Income taxes					
9.	Current	(6,064)	2,582	(3,482)	94	(3,388)
10.	Deferred	4,107	1,045	5,152	(1,057)	4,095
11.	Investment Tax Credits	535	-	535	-	535
12.	Amortization of Investment Tax Credits	(22)	-	(22)	-	(22)
13.	Amortization of Excess Deferred Taxes	-	-	-	(62)	(62)
14.	Total Operating Expenses	$ 31,464	5,412	36,876	(1,245)	35,631
15.	Operating Income	$ 1,579	$ 827	$ 2,406	$ 1,245	$ 3,651
16.	Amortization of Pre-1974 Profit on Debt Reacquired at Discount				14	14

17.	Total Available for Return	$ 1,579	$ 827	$ 2,406	$ 1,259	$ 3,665
18.	Rate Base	$ 51,559	$ (9,028)	$ 42,531	$ (17)	$ 42,514
19.	Rate of Return	3.06%		5.06%		8.62%

Section C - Cost of Capital

Capital Structure, Cost of Preferred Stock and Cost of Long-Term Debt

53. The parties presenting technical cost of capital testimony in this proceeding, namely MDU and MCC, agree on capitalization ratios and the costs associated with preferred stock and long-term debt. The Commission has examined these and finds them reasonable.

54. Because some confusion has existed surrounding the proper approach to be used in determining capital structure amounts for the gas and electric~utilities, the following explanation is offered.

55. Starting with the consolidated MDU company's common equity, investment in all nonutility subsidiaries is deducted, which leaves utility common equity. The ratio of gross gas utility plant plus gas construction work in progress to total gross utility plant plus total utility construction work in progress is then applied to total utility common equity to determine the portion attributable to the gas utility. The same ratio is applied to total utility preferred stock. The ratio is also applied to utility debt, but only after REA mortgage notes and pollution control debt are allocated directly to the electric utility. The same procedure should be used in computing the electric utility capital structure.

Comparable Companies, Comparable Risk

56. The logical starting point in determining MDU's cost of equity capital is the determination of firms with which it must compete for capital. The Bluefield Waterworks & Hope Natural Gas cases provide the following guidelines:

> 1) The company must be allowed the opportunity to earn returns on common equity sufficient to enable it to attract new capital on reasonable terms;
>
> 2) The company must be allowed the opportunity to earn returns on common equity sufficiently high to enable it to maintain its financial integrity;
>
> 3) The company must be allowed the opportunity to earn returns on common equity commensurate with the returns earned by other companies having comparible risks.
>
> (Fitzpatrick Direct Testimony, p. 7)

57. Dennis B. Fitzpatrick, MDU's cost of equity witness, determined that four criteria commonly referenced by investors are determinative of companies comparable in risk to MDU:

> The first sample consists of all electric utilities whose first mortgage bonds are rates single A by Moody's and Standard & Poors. MDU's bonds are presently rated single A by both rating agencies. The second sample includes all electric utilities that have a Soloman Earnings Quality Rating of C. Since Solomon Brothers currently rates MDU's earnings quality as C the companies included in this sample exhibit investor risk characteristics comparable to MDU. The third sample is comprised of all electric and gas utilities with Value Line Betas between 0.70 and 0.80. Since MDU's Value Line Beta is presently 0. 75, these companies have essentially identical systematic or market risk as MDU. Finally, the fourth sample includes all natural gas distribution companies surveyed by Value Line.
> (Fitzpatrick Direct, p. 24)

58. Fitzpatrick selected four parameters commonly used by investors to establish comparability with MDU, but he failed to explain why he chose them above other relevant factors, such as natural gas companies with single A bond ratings or, in the alternative, all utilities having single A bond ratings. Fitzpatrick did, - however, select his firms on the basis of "objective" or at least quantifiable risk criteria. The next logical step would be to test the correlation between those firms and MDU using commonly known statistical tools.

59. Basil L. Copeland, Jr., who testified on behalf of Montana Consumer Counsel, does not state how he chooses his sample of comparables, but does state:

> Under current market conditions, I have found that a sample size of 10-15 companies produces optimum results. As the sample size gets larger, the problem of heterogeneity (noncomparability) in the data arises. Any analysis based on a limited sample size immediately provokes the question of comparability. How do I know, for instance that the companies are of comparable risk? One of the advantages of a testable market model is that it provides an answer to this question. Noncomparability, to the extent it exists, will be reflected automatically in the standard error of the intercept.
> (Copeland Direct, pp. 42,42)

60. It is true that similarity between firms should be tested by using statistical tools. However, because Copeland failed to explain the process he used in establishing his sample, the Commission does not know if the firms he chose are those most comparable to MDU and also why they exhibit risk characteristics similar to MDU.

For example, companies such as Standard & Poor and Moody devote large amounts of resources and time to establish risk relationships. These companies have established and maintained a credible reputation with large bodies of investors because of the high quality of their risk rating systems.

61. However, according to Fitzpatrick, firms included within Copeland's sample overlap risk boundaries set forth by these ratings agencies:

> And for example, for the electric utility sample that he used, there were several companies that were rated Double A, I think. In fact, five companies of his fifteen are straight Double A credits; whereas, MDU is Single A. MDU's safety ranking is 3. Only one other company in that sample had a ranking as low as 3. The rest were 1's and 2's.
>
> Value Line's beta coefficient for MDU was .8, the highest of any of the companies included in this sample. The rest of the companies had betas anywhere from .55 to .75.
>
> Financial strength for MDU as reported by Value Line was B plus plus. Out of the 15 companies, there were only 5 that were ranked as low as B.
>
> So, by looking at this information, I was able to determine that these companies were probably not the best companies that could have been selected.
>
> (Tr. pp. F-14, F-15)

62. Dr. Fitzpatrick's assertion is not conclusive. The rating agencies to which he refers most likely use statistical techniques similar to those used by Copeland in establishing their ratings. The Commission does not know the reasons for the discrepancy but finds that it is not further explained by Fitzpatrick. The point is raised by the company's witness, but Copeland is never cross-examined on it. (Copeland volunteers that "the variation between B Double A and a Double A company may at times go 100 basis points, at times below." (Tr. p. C-32).)

Dcf Analysis

63. Fitzpatrick's Dcf analysis consists using two month and six month averages. This alleviates a Commission concern expressed in Order No. 4784, Docket No. 80.7.52, that use of spot yields is unreliable. Growth rates are computed by multiplying retention rates by the return on equity for: 1. 1980, 2. 1976-1980, and 3. 1971-1980. A fourth growth rate is taken directly from Value Line. The four growth rates are then averaged.

64. An area of concern to MCC witness Copeland is Fitzpatrick's failure to include a technical mathematical analysis:

> In his application of the DCF method, Dr. Fitzpatrick has relied entirely upon what I call descriptive analyses. He has analyzed past, present, and projected rates of dividend growth

> and then has assumed that the growth rates so formed are reflective of investors' expectations. I would emphasize that the dividend growth rate expectations so formed are merely those of Dr. Fitzpatrick; they are not the expectations of the marketplace. He has merely substituted his judgment for the judgment of the marketplace. He has not performed a rigorous technical analysis whereby inferences as to what the market is expecting might be formally derived from a testable market model. He has failed to state, prior to performing an actual analysis, what relationships in the data would cause him to question the reliability of his findings. I thus disagree fundamentally with Dr. Fitzpatrick's methodological approach. It is not structured in such a way as to minimize the influence of subjective preconceptions on the objectivity of his findings.
> (Copeland Direct, pp. 76, 77)

65. The Commission finds Copeland's assertions correct. Fitzpatrick's analysis is only slightly better than a "comparable earnings" analysis, which was the primary tool used to determine the cost of equity before Professor Gordon introduced more precise methods several years ago. Fitzpatrick uses Gordon's model, but fails to apply modern statistical techniques to test the validity of its application.

66. Another area of concern expressed by Copeland is Fitzpatrick's use of Value Line growth projections:

> Q. What observations do you have for this Commission on Dr. Fitzpatrick's use of Value Line?
>
> A. I stated earlier that it was untrue that Value Line projections are based on the belief that regulators will attempt to adjust rates for the sharply higher capital costs of recent years. Value Line's methodology is hardly refined enough to take account of anything of the sort. Value Line's projections are made by correlating the sales, earnings, and dividends of a company to appropriate components of the GNP in a hypothetical future economy. The accuracy of such a procedure depends upon (1) whether or not a firm's historical relationship to the economy as a whole remains unchanged, and (2) whether the assumptions used to construct the hypothetical future economy are ever realized. The purpose of this exercise is to measure "relative growth potentiality" (Value Line, Part 1, Summary and Index, p . 2, October 23, 1981) . The individual company assessments made by Value Line's analysts are totally ignored in developing these projections. Only the company's historical position relative to GNP and the projected future level of GNP

> determine the Value Line projections for an individual firm. The theory behind Value Line's projections is that it is not the absolute rate of growth in the dividend that is important for stock selection, but that it is the relative rate of growth that is important. For choosing one stock vis-a-vis another, the Value Line theory may have some merit. But for assessing the absolute rate of growth in the dividend for purposes of estimating the cost of equity, the Value Line numbers may be meaningless. Informed investors are aware of the limitations inherent in the Value Line approach. Many rate of return witnesses are not.
> (Copeland Direct, pp. 83, 84)

67. The Commission agrees with Copeland and further notes that the Value Line numbers are in every instance significantly higher than others computed by Fitzpatrick.

68. Copeland performs an elaborate, if not elegant, Dcf analysis. He restates the commonly used form of the Dcf equation to read: r = k + [D/B-D/P]. His reason for restatement is: "A regression of r on the quantity [D/B-D/P] for firms of comparible risk will accurately capture the structural relationships between market-to-book ratios, returns on equity, and payout ratios and retention rates." (Copeland Direct Testimony, pp. 39, 40) It thus addresses a concern of the Commission stated in MDU order No. 4467, Docket No. 6567:

> To determine the appropriate cost of equity, the Commission has examined the points of contention raised by all parties with due care and diligence. This is, of course, an extremely subjective area, the outcome of which can hinge upon differing applications of statistical techniques, the choice of companies having comparable risks for use in discounted cash flow (DCF) analysis, etc. The parties are called upon to make numerous judgements, some of which the Commission finds to be deficient on the part of both parties. For example, applicant's case states on pg. 8, lines 4 and 5 of Kuric's direct testimony that the rate of return on equity should be set to maintain a dividend payout ratio on utility operations of 55% - 60%. MCC's case, however, uses a 70% payout ratio on pg. 109 of Wilson's testimony. In neither case is the payout ratio used adequately defended. Since both parties present DCF analyses, which are based on dividend yield and growth, it remains a mystery why the payout ratio question is not sufficiently addressed.
> (P. 8, Finding No. 21)

69. MDU, through its prefiled rebuttal and cross-examination attempts to establish that Copeland's Dcf equation is not functionally straightforward -- that it puts the cart before the horse:

> Q. Mr. Copeland, I think you have a very good idea of where I'm going next. Isn't it true that for a valid linear regression, you have to get your variables straight? You have to make sure that the changes in the independent variable cause the changes in the dependent variable?
>
> A. True.
>
> Q. Isn't it true in this case, you're saying that instead of earnings of the Company affecting stock price, you're running a regression where you plug in, in essence, the stock price function with dividend, D/ -- -D/P and saying, "Now I can calculate the rate of earnings"?
>
> A. I believe in some of my published papers, I've explained that in terms of the functional relationship of what causes what, the equasion (sic) is essentially backwards. However, I also explained that there are statistical reasons why it's preferable to estimate it that way than to estimate it the other way around; that the problem --Perhaps you're familiar with this, but the problem known as errors and variables, and if you run the regression the other way around, you don't know what R is, and that would be an improper statistical calculation, but you do know what D/B-D/P is because that can be simply calculated.
>
> So, there are statistical reasons for running the regression the way I do.
>
> (Tr. p. C-17, C-18)

70. The company further attempts to discredit Copeland's formula by computing an alternative regression based on the formula:

$$R - (D/B - D/P) = K.$$

MDU suggests that results of applying this formula to Copeland's data proves that his formula is tainted by correlation between the independent variable and the error statistic, and because of this statistical relationship Copeland's model is functionally incorrect:

> Q. Isn't it true, Mr. Copeland, that if we set the regression as we have done in the second formula and used your data for R, for D, for P, and for B, and run that regression which has no independent variable, testing to the constant K, and the constant is of course your cost of capital that you derived from 1980, that we find

not only was your DCF estimate of 15.10 statistically valid, but that because of the fact the second regression has no independent variable and because of the fact it came up with a statistical validation, that your formula, the first one, in fact had serious problems between correlation in the independent variable and the error statistic?

* * *

A. I understand the question, and without being argumentative, I have to answer no, and I don't think that I can make that conclusion that you asked me to draw in that question from these regressions that Dr. Fitzpatrick has done, because I don't think those regressions on that transformed equasion (sic) tell you anything about the other equasion (sic).

Furthermore, I believe that these regressions would always be statistically significant under any circumstances because you are regressing against this constant, the data from which you derived the constant. It is not independent. And I don't see any way in which you could not have statistically significant results.

Now, if that K were derived independently of the other data, then there might be some usefulness to this approach, but I don't see it saying anything about the original equasion (sic).

Q. My question was, if you run the regression on the second formula, isn't it true that you will develop a K constant from the regression?

A. You have to derive the constant to do the regression. The constant is -- If you're regressing it on something with no slope, then the constant is the mean. All you're really doing is calculating on the right-hand side of the equasion (sic) the mean of all of the values on the left-hand side of the equasion. Then you are calculating or doing an analysis of variance of the numbers on the lefthand side of the equasion around that constant on the right-hand sice of the equasion. Since that number on the right-hand side is derived from the numbers on the left-hand side, it's always the best univalent predictor of the numbers on the left-hand side. Because it's the mean of those numbers. But it doesn't tell you anything about the other equasion or about whether the other equasion is a good equasion or not.

Q. In other words, you admit the second derivation is algebraically correct as you did that your first derivation is algebraically correct. They're both algebraically correct derivations of DCF formula.

A. Yes, they are, but the first equasion (sic) is stated in such a way as to provide you with an independent prediction that is relative to the slope of that line; that it should be 1. The only prediction you have in the second equasion is that the mean is 15. 1, but you derived that from the data, so you were not independently checking anything.

Q. Mr. Copeland, isn't it true that the second derivation specifically is a check on correlation between the independent variable and the error statistic in the first variable on top? Let's just set aside for the moment whether it's an independent method of calculating the cost of capital.

A. Okay.

Q. Isn't it true the second derivation is the proper method to measure for impermissible correlation between the independent variable and the error statistic?

A. I don't agree. Every single one of these regressions and every single one that I could conceive of would come out with a significant T test. I don't know what it would prove. Because all you're really doing is an analysis of variance around the mean of these numbers. And that mean is a pretty good predictor because I chose in the sample companies that are fairly comparable in risk.

Q. Are you saying again now that your DCF estimate is not a mean, despite the fact your sheet, as we've already gone through before, specifically identified your 15.18 DCF as a mean?

A. I'm not denying that it isn't a mean. I'm simply denying that the second equasion (sic) tells you anything about whether the error term in the first equasion is correlated with the independent variable in such a way as to cause me to reject the equasion, and I'm saying no.

Q. You did note and admit that the T statistic on the second equasion (sic) was significant, didn't you?

A. I admitted that it would always be significant under any circumstances that I could perceive, and something

> that proves everything proves nothing. I don't see what kind of a test it is. It's not a test.
> (Tr . pp . C-25 through C-30)

71. This testimony provides the Commission with no choice but to accept Copeland's assertion that his formula is an independent predictor, that no impermissible correlation exists between the independent variable and the error statistic. The company didn't testify or establish through cross-examination that significant correlation between the independent variable and the error statistic for the second equation is critical to the validity of Copeland's Dcf model. Further, MCC's reply brief points out that evidence was made available to the company proving that no correlation existed, but that the company chose to ignore it. MCC attached this data to his brief as Appendix A.

72. Another area of concern to the company is Copeland's modification of 1980 Dcf data to explain changes in investor expectations. He hypothesizes that investors expected dilution from issuing shares below book, and therefore expected a smaller growth rate.

The Commission was somewhat perplexed by Copeland's assertion that "we cannot ignore investors' expectations for continuing dilution as new shares are issued at prices below book value." (Copeland Direct Testimony, p. 49) However, the following analysis of the statement leads the Commission to find it valid.

73. For the sake of discussion, if one were to take Copeland's statement one step further it would seem that a downward adjustment should be made for rate of return expectations for a firm about to go into receivership (i.e. they would be very low or negative) Maintenance of a market to book ratio below 1 may be an early sign of poor financial health or recessionary economic conditions; insolvency is a dramatic sign. Both events increase risk in varying degrees and therefore increase the return needed to attract and hold equity capital.

74. It is true that investors may <u>expect</u> a lower return from firms experiencing dilution upon the sale of new shares, but dilution raises the <u>cost</u> of equity capital. If investor expectations for a firm and the marketplace cost of capital increasingly diverge over a <u>significant time period</u>, the firm will become insolvent because of its inability to attract new capital or maintain existing capital. Public utility commissions must, therefore, attempt to relate return granted to the marketplace <u>cost</u> of capital if continuation of the service being provided is deemed to be in the public interest.

75. Is then, consideration of lower investor expectations resulting from dilution appropriate in determining the cost of capital for MDU in the current instance? The answer is yes. The cost of equity is a marketplace determination made in reference to firms of equal risk. Most utilities currently trade below book value and routinely sell new securities below book value. This reflects generally unfavorable economic conditions. If the Commission were to ignore this marketplace determination, it would ignore the standards set forth in the Hope & Bluefield cases.

76. Increased risk from dilution is also reflected by the marketplace through its demand for extremely high rates of return to compensate for, among other things, a high level of "financial" risk. To account for higher financial risk and not lower investor expectations would provide a windfall to MDU's stockholders.

77. A further area of concern to MDU is Copeland's use of averages:

> Q. Mr. Copeland, isn't it true that you have developed literally an average cost of capital, average in terms of years, average in terms of company, in your sample?
>
> A. Yes, I have, but the point of doing the statistical analysis is to see whether the theory that underlies the developments of this average embodies certain structural relationships that can be verified through empirical analysis. Now, that's important to me. Anyone can come up with an average cost of equity, but I think it's important to say that the theory that I use to come up with this average cost of equity, does it lead to certain empirically verifiable relationships? And if it does, then it provides me with a good deal of confidence in making a recommendation based upon that cost of equity. It's just an additional step in estimating the cost of equity, providing some degree of confidence in making that recommendation to the Commission. (Tr . p . C-22)

78. Use of averages also concerns the Commission. Nagging questions belie quick answers. For instance: When can present economic conditions (which many say were triggered in late 1979 by actions of the Federal Reserve Board) be considered the norm rather than an aberration? Should post-1979 experience be weighted more heavily in computing the cost of equity capital?

The Commission notes that while Copeland uses five year averages, Fitzpatrick uses five year and ten year averages in computing his growth rates, although he weighs

1980 more heavily by including growth rates for 1980 individually, in addition to averages which include 1980.

It is apparent that the parties believe use of averages conveys more benefits than inequities. The Commission does find, however, that weighting given 1980 by Fitzpatrick is more reflective of current economic conditions.

Issuance Costs

79. Fitzpatrick computes the result of issuance expenses and market pressure in his study of MDU's 1978, 1979 and 1980 common stock offerings. He concludes that these costs averaged 6.44 percent as shown on DBF-52. He also specifies that these costs are applicable only to newly issued stock:

> Q. HOW DO THE UNDERWRITING AND MARKET PRESSURE COSTS AFFECT MDU'S COST OF COMMON EQUITY CAPITAL?
>
> A. The underwriting and market pressure costs have no effect on MDU's retained earnings or previously issued common equity. It is therefore my judgment that MDU's cost of retained earnings and previously issued common equity is in the 16.0 - 16.5% range for the Company's electric and gas utility operation. However, the underwriting and market pressure costs have a profound effect on the Company's new stock offerings. In order to compute the effective costs of new common equity offerings, the cost of retained earnings must be adjusted for the effects of these costs. I show these adjustments on Schedule D. B . F. - 2. The end result is that the cost of new common equity capital to MDU is 70 basis points higher than the cost of retained earnings and previously issued common equity.
>
> (Fitzpatrick Direct, pp. 37, 38)

80. Copeland stated: "Flotation costs can be documented and quantified and deserve consideration in determining a fair and reasonable rate of return." (Copeland Direct Testimony, p. 90)

With respect to issuance expenses he specified: "A preferable alternative to any adjustment to the rate of return would be to allow the firm to capitalize any stock expense actually incurred and then to permit recognition in the cost of service the amortization of this expense at the general depreciation rate. " (Copeland Direct Testimony, p. 92)

With respect to market pressure, Copeland stated:

> Dr. Fitzpatrick referred approvingly to the abundance of evidence of the fact that U.S. capital markets are "efficient"

> (Testimony, p. 31, lines 11-13). I have already argued that there should be no need to discount the price of a stock at the time of a stock issue in order to find a buyer. But suppose, momentarily for the sake of argument, that a firm did have to discount new issues in order to sell them. An opportunity for arbitrage would develop. An investor could refrain from purchasing the stock until the time of the new issue, at which time he could buy at less than the market rate. A rush of investors to buy the stock at less than its intrinsic value would bid the price right back up to what it is worth. There is just no way to rationalize the concept of market pressure with the concept of an efficient market.
> (Copeland Direct Testimony, p. 95)

81. The Commission finds Copeland's reasoning to be persuasive with respect to market pressure. It also finds the amortization alternative respecting issuance expenses to be more consistent with the "known and measurable" concept adopted by this Commission on many occasions.

Commission Determination

82. Fitzpatrick's cost of equity calculations range from 13.7 percent to 18.5 percent, and he recommends the virtual average of these numbers, 16 percent.

Copeland's calculations range from 11.79 percent to 14.24 percent, and he recommends 13.75 percent based on the conclusion that MDU's investor-required rate of return on equity was in the range of 13-14 percent.

The Commission finds that because of the above discussed unknowns associated with Copeland's comparable companies that it must refer to Fitzpatrick's cost of equity calculations, adjusted for the noninclusion of Value Line growth projections. Six month dividend yields will also be referred to, rather than two month average yields. This equity return reflects a dividend yield of 11.20 percent and a dividend growth rate of 3.5 percent.

Cost of Capital Table

83. In view of this discussion, the Commission finds the following cost of capital for MDU:

	Amount ($000)	Ratio	Cost	Weighted Cost
Long-Term Debt	$ 67,864	46.87%	8.42%	3.95%
Preferred Stock	20,769	14.34	7.80	1.12
Common Equity	56,162	38.79	14.70	5.70
Total	$144,795	100.00%		10.77%

Section D - Revenue Deficiency

84. The Commission finds the following revenue deficiency:

Montana-Dakota Utilities Company
Gas Utility - Montana
Revenue Deficiency
December 31, 1980 Test Year
(000)

1.	Gas Utility Rate Base	$42,514	
2.	Recommended Rate of Return	10.77%	
3.	Recommended Return		$ 4,579
4.	Available for Return		3,665
5.	Return Deficiency		914
6.	Revenue Deficiency		1,816
7.	Additional Revenues		$ 1,816
8.	Consumer Counsel Tax @ .07%		1
9.	State Taxable Income		1,815
10.	State Income Tax @ 6.75%		123
11.	Federal Taxable Income		1,692
12.	Federal Income Tax @ 46%		778
13.	Additional Income		$ 914

85. This amount constitutes 35.32 percent of the company's revised request of $5,141,000. If the unjustified "Conditional Adjustment" of $2,500,000 were excluded from the company's request the Commission approved revenue increase would constitute 68.76% of the company's requested amount.

Section E - Off System Sales

86. On February 19, 1982 the Federal Energy Regulatory Commission (FERC) issued an order granting MDU a certificate to make sales for resale to Colorado Interstate Gas Company and MIGC, Inc. and approved rates applicable to such sales in Docket No. CP81-316 et al.

87. These interstate sales were to commence March 1, 1982. On March 3, 1982 MDU filed with the Commission, pursuant to the stipulation submitted July 31, 1981 regarding conditions of interim rate increase, its application for an interim rate decrease.

88. The total amount attributable to the Montana decrease is computed as follows:

		Residential and Commercial	Industrial	Total
1.	Current Gas Cost Without Off System Sales (per Docket No. 81.10.98)	104.5064	113.6574	
2.	Current Gas Cost With off System Sales (per Docket No. 81.10.98)	71.9864	78.2904	
3.	Gas Cost Attributable to Off System Sales	32.52 4	35.367 4	
4.	Sales Base Pressure Volumes from Sch. J-2	13,442,079Mcf	4,73,000Mcf	
5.	Total Gas Cost Component	$ 4,371,364	$1,581,966	$5,953,330
6.	Total Fixed Cost Component From Revised Sch. H-14, p. 1 (MT portion) as filed 3/3/82			$1,778,486
7.	Total Revenue Decrease From Off System Sales			$7,731,816

89. The transaction contemplates total sales of 20 Bcf per year on a firm basis for five years.

90. In this order, only the fixed cost portion attributable to the sale is approved on a final basis. The current gas cost portion will be discussed in the order for Docket No. 81.10.98.

91. The revision of the fixed cost portion from that included on H-14, p. 1 of the workpapers filed with the application ($2,036,364) was due to FERC's acceptance of amounts included in MDU's certificate application rather than amounts included in MDU's currently pending FERC rate case.

92. The Commission finds the off-system sale to be in the best interests of all parties involved. The company is to be congratulated for its effort in solving what could have been a take-or-pay dilemma. The off system sale provides relief from short-term surpluses while maintaining long-term reserves.

Section F - Audit/Weatherization Program

93. The Commission finds that the present audit/weatherization program is loosely administered, costly, and ineffective. For the time being these problems may be attributed to the program being in a start-up stage, and lack of management emphasis by the Company. Therefore, a downward adjustment in audit/weatherization expense is not yet warranted. Rather than hold the Company to minimum performance standards at this time, the Commission will instead expect to see significant improvement in the following performance ratios, in order of priority:

ANNUAL

1. Loans per audit conducted
2. Low income loans per low income energy assistance qualified customer
3. Audits per total audit/weatherization program dollar
4. Loans per thousand customers
5. Audits per thousand customers
6. Loan size.

Toward these ends, the Commission is amenable to program modifications such as: Leaving repayment obligation with rental structures to be paid by subsequent residents; no liens upon owner occupied dwellings; pay back periods to seven years for low income energy assistance qualified customers; a nominal service charge ($10) for audits to improve customer commitment; auditing contractors; and use of federal and state tax benefits pertaining to renewable energy equipment. The Commission would contemplate that the loan limit for renewable equipment (particularly solar hot water heating equipment) would be "grossed up" by the amount of the tax benefits, which the customer would pay to MDU on April 15th of the following calendar year. For example, if the current loan limit were $1,500 and a 40 percent tax credit were available for renewable energy equipment, the company could loan X- .4X=1500 or $2,500. The $1,000 tax credit would be paid to the company at April 15th of the following calendar year. Monthly payments on the $1 , 500 balance would not be affected . In summary, the Commission expects significantly improved emphasis and performance in the audit/ weatherization program.

Section G - Economic Recovery Tax Act of 1981

94. By letter dated April 13, 1982 the PSC was informed by MDU counsel that this order must include a provision approving normalization accounting for accelerated cost recovery system deductions provided for in the Economic Recovery Tax Act of 1981. Although this matter was not raised on the record, the Commission understands the vagaries of the Act, and therefore, approves normalization of accelerated tax depreciation benefits associated with Economic Recovery Tax Act of 1981 property. This action does not affect revenues in this proceeding since no "recovery" property has been included in the rate base.

Section H - Rate Design

95. Findings of Fact Nos. 39, 43, 44 and 45 of Order No. 4635 in Docket No. 6695 and Finding of Fact No. 70 of Order No. 4784 in Docket No. 80.7.52, MDU's most recent previous gas cases, set forth the principal elements of the

volumetric pricing structure adopted by this Commission in those cases. Those findings provided for firm customers an inverted block rate structure with an initial block of 15 Mcf's during the months of December through March priced at a 25 percent discount in all schedules covering firm sales. Remaining Mcf's are, according to these orders, to be priced volumetrically at the level necessitated by the revenue requirement. Furthermore, the Commission found it reasonable that industrial users share in the cost of providing underground storage, and that the differential between industrial users and firm class users was no longer appropriate and was discontinued.

96. The Commission finds no substantive testimony in this record advocating any position other than the one set forth above and, therefore, finds a continuation of that rate design to be proper.

97. The Commission has received numerous complaints regarding the lifeline period, which was intended to cover usage between December 1st and March 30th. Because of cycle billing, the practical application has been usage between December 1st and April 30th, depending on when meters are read. The Commission finds that the only practical method of alleviating late April from the lifeline period is to move the period forward 15 days so that meter readings between November 15th and April 15 apply. The Commission realizes that this cuts 15 days from the 1982 eighth month recovery period. The Company should compute the revenue affect of this charge based on normalized consumption amounts in this case and submit it with its November, 1982 deferred accounting-tracking case.

98. Included in the application to increase rates was a request for approval of a late payment charge of 1 percent per month on any unpaid balance. MDU stated in their opening brief that the proposed late payment charge "was not contested by any party." The Commission finds that during the special evening sessions the record is clear that the public opposes any increase in rates or any charge that produces an additional burden in paying their utility bill. Many people

testified that they pay as much for their winter bills as they can afford. Imposing a late charge would add additional burden to these people. In light of the state of the economy that we are currently in and the testimony of numerous witnesses in this case, the Commission finds that a late charge is not appropriate.

CONCLUSIONS OF LAW

1. Applicant, Montana-Dakota Utilities Co., is a corporation providing natural gas services within the state of Montana and as such is a "public utility" within the meaning of Section 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's operations pursuant to Title 69, Chapter 3, MCA.

3. The rate base adopted herein reflects original cost depreciated values and as such complies with the requirements of Section 69-3-109, MCA, that the value placed upon a utility's property for ratemaking purposes "...may not exceed the original cost of the property."

4. The rate of return allowed meets the constitutional requirement that a public utility's return must be "commensurate with returns on investments in other enterprises having corresponding risks and sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. " Federal Power Commission v. Hope Natural Gas Company, 320 U. S. 591, 603 (1944).

5. The Commission acts in its legislative capacity when it allocates utility costs to the various customer classes.

6. The objectives of conservation, efficiency and equity are promoted by the rate structure approved in this order.

7. The rate structures authorized by the Commission, based upon analysis of the entire record, are just, reasonable, and not unjustly discriminatory.

ORDER

1. The Montana-Dakota Utilities Company shall file rate schedules which reflect annual gas utility revenue increases of $1,816,000. This constitutes $7, 500 of additional annual revenue above that granted pursuant to temporary increases.

2. Because of the diminimus nature of the additional revenue increase, MDU is encouraged to include this amount in its request for June interim rate relief in its deferred accounting-tracking filing. Interest at the equity rate of return may be included thereon. This approach minimizes the number of rate changes to the consumer, which currently number four in this Docket.

3. Rate schedules filed shall comport with all Commission determinations set forth in this order and in such manner so as to increase rates in accordance with the volumetric pricing methodology maintaining the 25 percent differential between winter discount and remainder of year rates.

4. The temporary reduction of revenue of $1,778,486 on an annual basis attributable to the fixed cost portion of the off-line sale to CIG and MIGC is approved and hereby made permanent.

5. All motions and objections not ruled upon are denied.

6. This order is effective for services rendered on and after April 13, 1982.

Done and dated this 13th day of April, 1982 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

GORDON E. BOLLINGER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill
Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.47306. ARM.

Service Date: may 12, 1982

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * *

IN THE MATTER Of The Application Of	)	
MONTANA -DAKOTA UTILITIES COM-	)	UTILITY DIVISION
PANY For Authority To Establish	)	DOCKET NO. 81.7.62
Permanent Increased Rates For Gas	)	ORDER NO. 4834c
Service In The State Of Montana.	)	

ERRATA SHEET

Page 40, Finding of-Fact No. 97, Line 7, should read:

". . . meter readings between December 15 and April 15, apply.", rather than ". . . meter readings between November 15 and April 15 apply."